



OIG

Office of Inspector General



Semiannual Report to Congress

April 1 – September 30, 2002



BOARD OF GOVERNORS
OF THE
FEDERAL RESERVE SYSTEM
WASHINGTON, D. C. 20551

OFFICE OF INSPECTOR GENERAL

October 30, 2002

The Honorable Alan Greenspan
Chairman
Board of Governors of the Federal Reserve System
Washington, DC 20551

Dear Chairman Greenspan:

The enclosed *Semiannual Report to Congress* summarizes the activities of the Office of Inspector General of the Board of Governors of the Federal Reserve System (Board) for the reporting period April 1 through September 30, 2002. During this reporting period, we continued to perform a variety of audits, reviews, investigations, and special projects covering a wide range of the Board's programs and operations. Our accomplishments and work in progress are listed according to our strategic goals and objectives.

The Inspector General Act requires that you transmit this report to the appropriate committees of Congress within thirty days of receipt, together with a separate management report and any comments you wish to make.

Sincerely,

A handwritten signature in black ink, reading "Barry R. Snyder", is positioned below the word "Sincerely,".

Barry R. Snyder
Inspector General

Enclosure



Semiannual Report to Congress

April 1 – September 30, 2002

OIG

Office of Inspector General

Table of Contents

	Page
Introduction	1
Goal 1: Provide Value-Added Customer Service to the Board.....	3
Goal 2: Enhance Coordination and Information Sharing.....	15
Goal 3: Enhance Internal Operations	19
Appendixes.....	23
Appendix 1—Audit Reports Issued with Questioned Costs for the Period April 1 through September 30, 2002	25
Appendix 2—Audit Reports Issued with Recommendations That Funds Be Put to Better Use for the Period April 1 through September 30, 2002	26
Appendix 3—OIG Audit Reports and Recommendations.....	27
Appendix 4—Cross-References to the Inspector General Act.....	28

Introduction

The mission of the Office of Inspector General (OIG), as prescribed by the Inspector General Act of 1978 (as amended), requires that we

- conduct and supervise independent and objective audits, investigations, and other reviews of programs and operations of the Board of Governors of the Federal Reserve System (Board);
- promote economy, efficiency, and effectiveness within the Board;
- help prevent and detect fraud, waste, and mismanagement in the Board's programs and operations;
- review existing and proposed legislation and regulations and make recommendations regarding possible improvements to Board programs and operations; and
- keep the Chairman and Congress fully and currently informed of problems.

Additionally, the Federal Deposit Insurance Act (as amended) requires us to review failed financial institutions supervised by the Board that result in a material loss to the bank insurance fund and produce, within six months of the loss, a report that includes suggestions for improving the Board's banking supervision practices. Further, through an agreement with other financial institutions regulatory agency Inspectors General charged with the same legislative requirement, we will address any relationship of Board-regulated holding companies to material losses to the fund from failed financial institutions supervised by any of these agencies.

The OIG currently performs its duties and responsibilities under three major program areas (as shown in the organizational chart that follows). Combined, these program areas perform traditional audits and investigations as well as some nontraditional partnering with Board management and staff.

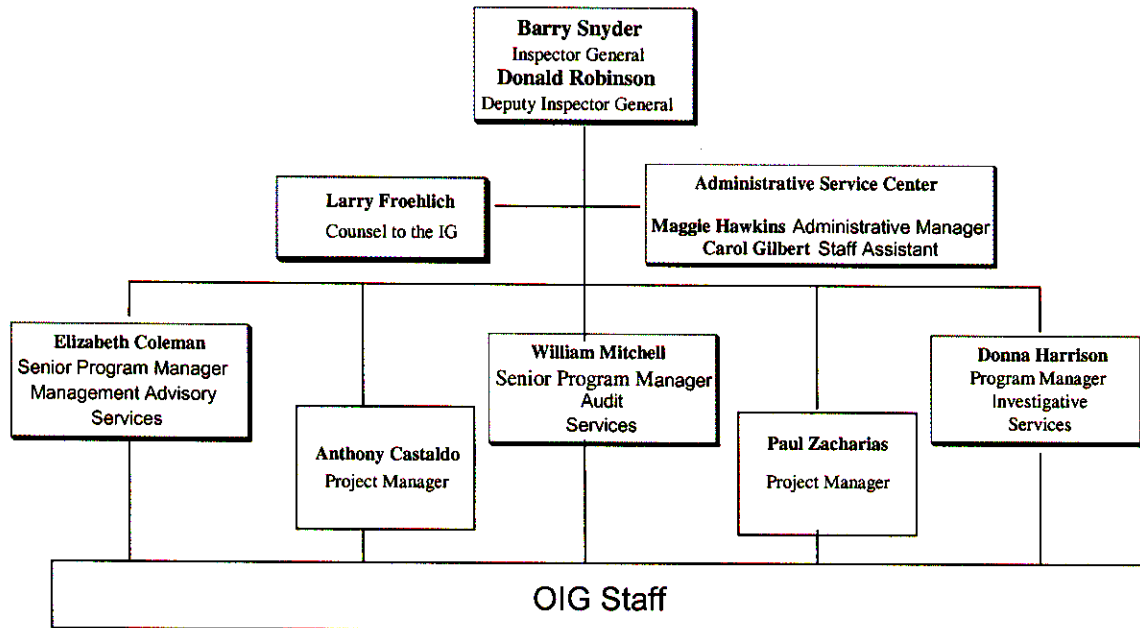
Our strategic plan for the period 2000 through 2004 includes the following three goals that guide our work:

- to provide value-added customer service to the Board;
- to enhance coordination and information sharing with the Congress, the Inspector General (IG) community, and others; and
- to enhance the efficiency and effectiveness of our internal operations.

We are submitting our accomplishments and work in progress as they relate to these strategic goals and related objectives. Our statistical tables, as prescribed by the Inspector General Act, are shown in appendixes 1 through 4.

Office of Inspector General

January 2002



OIG Staffing

Auditors	16
EDP Auditors	4
Investigators	4
Attorney	1
Administrative.....	2
Information Systems Analysts.....	2
Total Positions	29

Goal 1: Provide Value-Added Customer Service to the Board

Our first strategic goal focuses on providing value-added customer service to the Board. Our work within this goal focuses on the four strategic objectives that are described below.

Improve and Enhance the Board's Program Operations

The Board continues to operate in a dynamic environment, shaped by legislative reform, increased emphasis on results and performance management, and innovations in the banking industry that require corresponding changes in the Board's supervision and regulation programs, as well as its Federal Reserve System (System) oversight functions. Within this environment, we are focusing on improving and enhancing Board programs and operations. Our work under this objective for this reporting period follows:

Review of the Federal Reserve's Supervision of Hamilton Bancorp, Inc.

During this semiannual reporting period, we continued our review of the Board's supervision of Hamilton Bancorp, Inc. (Bancorp), a noncomplex bank holding company, that conducted operations through its wholly-owned bank subsidiary, Hamilton Bank, N.A. (Hamilton) and a nonbank subsidiary. On January 11, 2002, the Office of the Comptroller of the Currency (OCC) closed Hamilton and the Federal Deposit Insurance Corporation (FDIC) was appointed as Receiver. Hamilton's closure is estimated to result in a material loss to the FDIC's Bank Insurance Fund (BIF) as defined by section 38(k) of the amended Federal Deposit Insurance Act (FDI Act). Since the OCC was Hamilton's primary regulator, the FDI Act requires that the Department of Treasury's (Treasury) OIG review OCC's supervision of Hamilton to (1) ascertain why the institution's problems resulted in a material loss to the insurance fund; and (2) make recommendations for preventing any such loss in the future. Although not mandated by the FDI Act, we are in the process of reviewing the holding company supervision, as well as actions taken by the holding company and its nonbank subsidiary to determine if they contributed to the failure of Hamilton and the anticipated material loss to the BIF. We plan to summarize the results of this review during our next reporting period.

Material Loss Review Program Update

We initiated this review to ensure that our Material Loss Review (MLR) audit program was updated to reflect changes in the banking industry as well as supervisory policies and practices. To achieve our objective we

-
- revisited the universe of laws, regulations and congressional mandates related to the OIG's MLR responsibilities;
 - reviewed prior OIG MLR reports and workpapers to identify lessons learned; and
 - discussed methodology and best practices with OIG staff at other banking agencies that have conducted recent MLRs.

Our revised and updated MLR audit program has been completed and is currently being used on the Oakwood Deposit Savings Bank MLR.

Oakwood Deposit Bank Company Material Loss Review

On January 31, 2002, the Executive Vice President of the Oakwood Deposit Bank, a State Member Bank supervised by the Federal Reserve, confessed to fraudulent activity of sufficient magnitude to render the bank insolvent. The FDIC closed the bank the next day, and subsequently sold the institution's deposits and loan portfolio at a premium. In a letter dated April 26, 2002, the FDIC's Inspector General notified us that the Oakwood closing would result in a "material loss" to the BIF as defined under section 38(k) of the FDI Act.

During this period, we completed fieldwork that included collecting data and conducting interviews at the Board, the Federal Reserve Bank of Cleveland, State of Ohio Division of Financial Institutions, FDIC's Department of Resolutions and Receiverships, and at the main office of State Bank (formerly Oakwood Deposit Bank). We reviewed investigative files developed by federal law enforcement agencies along with supervisory records including surveillance reports, correspondence, examination reports, and available work papers for the five-year period preceding the bank's closure. We have completed our field work and are in the process of drafting the final report that will be issued during our next reporting period.

Audit of the Federal Reserve System's Surveillance Function

The Federal Reserve System's surveillance function tracks the condition and performance of individual banking institutions, assesses macro trends in the banking industry and the economy, and provides statistical and analytical support to the examination staff. Surveillance activities are performed at the Board as well as at each Reserve Bank. The importance of the surveillance function has increased now that the System has implemented a risk-focused approach to examination, which requires more extensive preexamination planning and scoping to ensure that examiners focus their efforts on areas that pose the greatest risks to an institution's safety and soundness.

During this period, we initiated an audit to evaluate the economy and efficiency of the System's surveillance program. Our work entails a Systemwide look at the surveillance efforts; the coordination between the Board, the Reserve Banks, and other regulators; and the overall efficiency of the System's surveillance activities. We have substantially completed the first phase of this audit, a scoping effort intended to develop an understanding of the purpose, content, and interrelationship of the Board's and Reserve Banks' surveillance systems and processes. During the next period we will complete the scoping effort and determine the appropriate work needed to further evaluate and report on any identified issues.

Follow-Up on the Audit of the Board's Oversight Approach for the Federal Reserve's Check Modernization Project

During the reporting period, we completed follow-up work related to our September 2001 *Audit of the Board's Oversight Approach for the Federal Reserve's Check Modernization Project*. Our audit report contained two recommendations to help the Division of Reserve Bank Operations and Payment Systems (RBOPS) enhance their oversight of the project by developing a more focused approach and by integrating the oversight approach in order to monitor and evaluate project issues.

We have determined that RBOPS has taken sufficient action to close the two recommendations. Specifically:

- RBOPS developed an oversight planning matrix to ensure that oversight planning was sufficiently detailed to provide an appropriately focused and sustainable approach for the remainder of the project. The matrix lists and weighs key project risks, defines oversight objectives for each risk, and specifies the strategies and tactics to accomplish each oversight objective.
- RBOPS has taken steps to better integrate the work of the Reserve Bank General Auditors and the RBOPS Audit Review Section into its project oversight approach, in order to promote improved communication between the two audit functions. The steps include (1) adding an audit assessment segment to the periodic check modernization status update to the Committee on Reserve Bank Affairs, (2) routinely including Audit Review Section personnel in project oversight team meetings, and (3) ensuring that Audit Review Section personnel regularly participate in conference call meetings with the General Auditors, and the Federal Reserve System's check modernization audit team, so that relevant findings regarding audit coverage can be communicated.

Strengthen and Streamline the Board's Operational Infrastructure

The Board continues to face certain challenges in ensuring that it has the people, processes, and technology that it will need to meet the evolving and varying needs of its clients and to provide a wide range of high-quality services in a cost-effective manner. To be effective, the Board will need to reexamine its financial management, human capital, administrative operations, and communications infrastructure with a view toward improving operations and strengthening accountability. We will provide value-added services to help Board management ensure that it has the integrated internal systems, policies, and processes it needs to meet these new demands. Our work under this objective during this reporting period follows:

Assessment of the Board's Recruitment Process

During this reporting period, we initiated and completed an assessment of the Board's recruitment process as it relates to recent changes in identifying, tracking, and reporting on applicants for Board positions. While we observed a consistent understanding of the changes in how the Board defines an applicant, we also found a general lack of coordination in implementing the new definition into the recruitment process and the supporting information systems. More specifically, reporting requirements under the new definition of an applicant had not yet been standardized, and recruiters were unclear about their responsibilities and expectations for identifying and referring top candidates to hiring managers. Until Human Resources (HR) and the other offices and divisions involved in the recruitment process come together to define a consistent understanding of their respective roles, responsibilities, and information needs, we believe that it will be difficult to address process efficiencies, determine staffing needs, and define requirements for an anticipated implementation of a new recruitment management software application. HR management generally agreed with our observations and indicated that they would take steps to clarify roles, responsibilities and requirements in acquiring the new application and implementing the new definition.

Review of Plans to Reorganize the Management Division's Support Services Function

During this period, we issued our *Report on the Review of Plans to Reorganize the Management Division's Support Services Function*. The objective of this assignment was to review internal control and economy and efficiency issues associated with the planned reorganization. To accomplish this objective, we interviewed key Management Division (MGT) staff, made benchmarking visits to

the Federal Reserve Banks of Philadelphia and Richmond, and reviewed documentation related to the reorganization.

We specifically analyzed the director's plans for five major changes that included:

- consolidating the MGT's administrative functions;
- creating a separate organizational entity within the MGT for Board Security;
- moving the Workers' Compensation Program to the HR Function;
- establishing a divisionwide Automation Support Group; and
- moving the review of background investigations and security clearances to HR.

Overall, we concluded that the proposed organizational changes did not present any material internal control concerns and appeared to be congruent with the director's goal of enhancing the MGT's operational efficiency. Our review did not address how the reorganization should affect the number, mix, and reporting relationships of managers and officers. In our view, these implementation issues, to a large measure, require judgmental decisions that are the province of senior division management.

Phase III of the Business Process Review of the Board's Publications Program

Our multiphased business process review (BPR) of the Board's publication program focused on the Publications Committee's efforts to transition the program from a document-based to an information-based communications approach that more fully optimizes the advantages of the internet and electronic media. The publications program supports the Board's missions by making information about the Federal Reserve accessible to the federal government, regulated entities, legal and business communities, libraries and research entities, economists and other scholars, consumers, and the public at large. The committee, composed of senior officials from several Board divisions and offices, oversees the program.

As a result of our phase I work, the committee adopted a five-step approach designed to help the Board streamline processing, promote efficient operations, improve performance, implement best practices, and optimize the use of technology in its publications program. During phase II, we analyzed the Board's *Annual Report* and *Annual Report: Budget Review* and briefed the committee chair regarding options for modifying these publications in recognition of information that is or could be available on the Board's public web site. The

committee chair generally agreed with our conclusions and developed an action plan for pursuing the issues with the full committee.

On this third phase of the BPR, we facilitated implementation of the action plan by briefing the committee on the potential for changes to the Board's *Annual Report* and *Annual Report: Budget Review*. We subsequently provided a more in-depth briefing on the same topic to two task forces that the committee had established to develop recommendations for modifying these publications and the *Federal Reserve Bulletin*. Finally, we closed out this project by briefing the recently-hired publications manager on the history and lessons learned from our BPR work. The publications manager position had been created as part of a reorganization and consolidation of Board publication responsibilities that was responsive to suggestions which we had provided over the course of our multi-phased BPR.

Management Division Capping Report

Over the past two years, the OIG conducted in-depth assessments of each unit within the MGT: HR, Finance, and Support Services. Our assessment work focused on each entity's strategy, organizational structure, internal control environment, management, core processes, use of technology, controls, staffing levels, and performance. During this period, we presented a capping report at a MGT strategic planning meeting that synthesized our entire body of work. Our capping report and briefing highlighted the principle results of our assessments, and provided MGT planners with a strategic context to assist their efforts in establishing the division's mission, vision, values, goals, and objectives.

Promote the Board's Effective Use of Technology

Information technology continues to advance at a rapid pace, requiring the Board to continually balance automation requirements and costs with service delivery, efficiency, and security concerns. While Board divisions and offices have made significant progress in integrating information technology into their work, a more fully integrated information technology infrastructure would provide enhanced support to the Board in achieving its mission-related, strategic planning, human capital, and business process objectives. Our work under this objective for this reporting period follows:

Audit of the Board's Information Security Program

On October 30, 2000, the President signed into law the FY2001 Defense Authorization Act, including Title X, subtitle G, "Government Information Security Reform" (Security Act). The Security Act requires each agency

Inspector General to conduct an annual independent evaluation of the agency's information security program and practices. This is the second year that such evaluations were required. Although the Security Act sunsets in 2002, legislation introduced in both houses of Congress would extend the Security Act's provisions or establish similar requirements going forward. Our specific audit objectives, based on the Security Act's requirements, were to evaluate the effectiveness of security controls and techniques for selected information systems and to evaluate the Board's compliance with the Security Act and related informational security policies, procedures, standards, and guidelines.

To test security controls and techniques, we selected two applications for review and followed up on the recommendations made during last year's control reviews. Our security control tests did not identify any major security control weaknesses, although we found that controls needed to be strengthened in several areas. Our follow-up work found that sufficient actions had been taken to close all recommendations on four of the five reviews; actions sufficient to close the fifth control review were in progress but had not yet been completed. We provided our test results and follow-up letters to management under separate restricted covers and we plan to follow up on implementation of all open recommendations as part of future audit activities related to the Board's implementation of the Security Act or subsequent legislation.

To evaluate the Board's compliance with the Security Act and related policies and procedures, we followed up on the seven recommendations in our 2001 Security Act audit report. These recommendations were designed to help bring the Board into compliance with the Security Act's requirements and further enhance the Board's information security program. Our follow-up work showed that actions had been initiated on most of the recommendations, and that the Board's organizational structure for information security has, in general, taken a broader perspective and more proactive approach to information security matters.

Notwithstanding the actions taken, issues remain open on portions of six of the seven recommendations. Specifically, we found that the roles and responsibilities of the Chief Information Officer (CIO), program officials, the Information Security Officer (ISO), the Information Security Unit, and the Information Security Committee have not yet been clearly defined. We also continue to be concerned that the ISO is not properly positioned within the Board's organizational structure to carry out his responsibilities effectively. In addition, our follow-up work showed that the CIO has not yet developed an agencywide information security plan, established comprehensive corrective action plans for control review results, finalized incident response guidelines, or established specific information systems security training requirements. Because all of the open items address requirements specifically cited in the Security Act, we believe that fully implementing the recommendations is essential for the Board to bring itself into compliance with the Security Act and to establish the organization and programmatic framework that the Security Act envisions. Implementing these

recommendations will also assist management in establishing a centralized approach for issuing technical guidance and promoting staff awareness on information systems security best practices and procedures.

We discussed the results of our work with the Staff Director for Management, who serves as the Board's CIO. The Staff Director noted that the Board's management priority over the past year has been to implement the new plans stemming from the events of September 11, 2001; and, to enhance the resiliency of the Board's continuity of operations plans for key central bank functions including the critical information technology systems that support the functions. Extensive information technology resources have been redirected to enhance the Board's disaster recovery, physical security, and emergency voice and data communications infrastructures. The Staff Director believes that good progress on the Security Act has been made, particularly in light of the change in priorities. The Staff Director recognized, however, that further actions are needed to close out all of the recommendations regarding Security Act compliance. The Staff Director emphasized the need to continue to have a strong security culture throughout the Board and agreed to continue studying the issue of properly positioning the ISO within the organization. We will evaluate actions taken in response to the open portions of our previous recommendations as part of our continued work related to information security.

BOND Life Cycle Assessment

The Board's Division of Banking and Supervision (BS&R) and the Division of Information Technology (IT) are developing the Banking Organization National Desktop (BOND). BOND is an automated application intended to support the supervision process by facilitating secure information-sharing and collaboration across the Federal Reserve System and with certain other financial regulators. BS&R is implementing the BOND application in phases and has asked the OIG to provide an independent perspective on the process. Our objective is to help ensure that the BOND application is being implemented in an efficient and effective manner, with proper attention to the control framework. To accomplish this objective, we gained an understanding of BOND and the system development enhancement efforts for the Central Document and Text Repository (CDTR) database that supports BOND.

During this reporting period, we presented status briefings highlighting observations from our assessment of the BOND to BS&R and IT project team members, culminating with a report to the BOND management team. Overall, we believe that the greatest long-term challenge facing the BOND project team is to fully integrate BOND into the supervision process so that it becomes an easy-to-use tool that users view as increasingly adding clear and visible value to their business processes. To meet this challenge, our report emphasized the importance of establishing the capability to accept a batch upload of supervision documents

from individual Federal Reserve Bank information systems, defining and documenting requirements, documenting unit tests and developing formal test plans, and preparing project plans. The BS&R and IT management team generally agreed with our observations and is taking steps to integrate automation systems such as BOND into the supervisory process.

Going forward, as part of our routine activities, we agreed to continue to attend key BOND meetings and to perform other work as warranted as BS&R and IT are implementing the next phase of the BOND development effort—providing web-enabled, access capabilities.

Help the Board Limit Risk and Ensure Compliance

The Board operates under a myriad of laws and regulations that impact many aspects of its programs and operations. For example, numerous tax and employment laws and regulations impact the Board's recruiting, compensation, and benefits programs. In addition, Board programs and operations may also be subject to potential damage or loss through fraud, waste, abuse, mismanagement, and employee misconduct. Our work under this object for this reporting period follows:

Audit of the Board's Security-Related Directed Procurements

In response to the events of September 11, 2001, and the subsequent anthrax threat, the Board made a series of thirty-two purchases totaling about \$3.7 million to enhance security and protect Board employees. These purchases were accomplished as directed procurements, which are an exception to required competitive procurement procedures allowed by Board policy under certain unique purchase conditions. We undertook this review in response to a verbal request from the former Administrative Governor who wanted assurance that he had appropriately exercised his delegated authority to approve these directed procurements.

Overall, we concluded that the former Administrative Governor appropriately exercised his delegated approval authority when he approved these directed procurements. In addition, MGT officials and Procurement Section staff were very successful in expediting numerous procurements to acquire security-related items and services to enhance the protection of Board employees. We found that these procurements were approved and undertaken consistent with the Board's "Acquisition Policy."

Our report contained three recommendations intended to enhance controls and reduce risks for future unique purchase condition procurements and to strengthen

controls over payments for fixed-unit-price service contracts. Specifically, we recommended that the director of the MGT:

- establish and implement written procedures for procurements initiated under unique-purchase conditions;
- revise the Board's "Acquisition Policy," in coordination with the General Counsel, to require a legal review of all procurements initiated under unique-purchase conditions; and
- strengthen the controls over payments for fixed-unit-price service contracts by requiring (a) vendors to submit additional documentation to support invoice amounts, (b) contracting officer's technical representative (COTR) to verify the accuracy of the invoices using supporting documentation submitted by the vendors, and (c) COTRs to establish an appropriate inspection or verification system.

In his written response to our report, the director concurred with the first recommendation, did not concur with the second; and partially concurred with the third.

In connection with the third recommendation, we found that documentation was not sufficient to support the payment of invoices in four fixed-unit-price service contracts. As a result, we have classified the \$1,341,195.90 paid under these four contracts to be unsupported costs. Management has decided to not disallow these costs.

Audit of the Board's Use of and Controls Over Purchase Cards

We completed our audit of the Board's use of and controls over purchase cards. Our audit objectives were to evaluate the purchase card program's internal controls, goals and objectives, and cardholder's compliance with current policy, and to determine whether procedures for issuing cards and ensuring proper use were adequate.

Overall, we found that existing internal controls over the Board's purchase card program are generally adequate. We did not find any unauthorized purchases (such as making travel-related purchases, obtaining cash advances, or making personal purchases) among the transactions reviewed as part of our sample. Cardholders were complying with the Board's written procedures regarding documentation and record keeping and had received initial training and instructions on the card's use. We also found that the Board's monthly payments to Bank of America were timely. We did not find any indication that the program was out of compliance with the terms of the contract with Bank of America or the interagency agreement with the Department of Interior.

Notwithstanding these conclusions, we believe that opportunities exist for the Board to enhance the program's effectiveness and further improve the control structure. We found that the volume of purchase card transactions and the number of cardholders remain low and that existing dollar limits may not be sufficient to meet all divisions' requirements. We also found transactions made by the Procurement staff that we believe should have been made by individual cardholders. As a result, the program is not maximizing the objective of reducing administrative costs for small purchases. In addition, we found that cardholders did not completely reconcile transactions and that processes within the MGT were insufficient for identifying active cardholders and promptly deactivating accounts.

Our report contains three recommendations designed to expand the use of the program and further reduce administrative burden, enhance the reconciliation process, and accurately identify current cardholders and promptly retrieve and deactivate purchase cards. We provided a copy of our report to the director of the MGT for his review and comment. In his written response, the director generally agreed to take action on all of our recommendations.

Audit of the Board's Outsourcing Efforts

In September, we began an audit of the Board's outsourcing efforts. Over the years, the Board has outsourced several of its functions, such as the servicing of its HR benefits program, its cafeteria and food services, and its cleaning and housekeeping maintenance. The objectives of this audit are to assess the Board's management of the contracts for outsourced services and to evaluate its processes for identifying and evaluating other competitive sourcing opportunities. We anticipate completing this audit during the next reporting period.

Investigative Activity

During the reporting period, we opened four formal investigations and continued work on twenty cases that were opened during previous reporting periods. Of the twenty-four active cases, we closed fifteen cases that were opened from the previous reporting periods. Nine of the fifteen cases closed involved the alleged frequent flyer abuse by Board employees and required the OIG to refer them to the Department of Justice to determine whether they merited criminal prosecution. The U. S. Attorney's Office declined prosecution of all nine investigations during the previous reporting periods in favor of administrative action. The action taken by the Board in eight of these nine cases resulted in eight management letters to the personnel files of the now-former Board employees. The remaining frequent flyer case was resolved by a settlement agreement between the former employee and Board management. The Board has also updated its travel policy to provide more guidance regarding the accumulation and use of frequent flyer awards.

Of the remaining six closed cases, two cases involved fictitious instrument fraud and one involved a misuse of the government travel card by an employee who subsequently retired and entered into arrangements to pay the outstanding balance on the card. In addition, we closed one case that was opened during an earlier reporting period which involved the possible unauthorized entry into the private office of a Board official and potential access to sensitive information. The evidence presented was inconclusive that an unauthorized access had occurred or if sensitive information had been disturbed or identified as missing. We also closed two cases involving the theft of Board computers. In the first instance, a Central Processing Unit (CPU) was reported missing from an employee's office. During the course of another investigation, the OIG recovered the "missing" CPU and returned it to Board management. The remaining computer theft investigation involved a missing laptop computer from an unlocked office used as an equipment storage room. This case was closed after exhausting all investigative leads. In both cases, the evidence revealed that no sensitive Board-related information was contained on these computers and security procedures have since been improved and upgraded.

With respect to our nine active cases, we are waiting on the Board's final decision and administrative action on two cases; one involving alleged frequent flyer abuse by a former Board official and the other involving the alleged theft of Board computer equipment. The U. S. Attorney's Office declined prosecution in both of these matters in favor of administrative action. To date, the Board has not taken any administrative action in these cases. At the end of this reporting period, we had nine active cases. Our summary statistics on investigations are provided in the table that follows:

Summary Statistics on Investigations for the Period of April 1 through September 30, 2002

Investigative Actions	Number
Investigative Caseload	
Investigations Opened during Reporting Period	4
Investigations Open from Previous Period	20
Investigations Closed during Reporting Period	15
Total Investigations Active at End of Reporting Period	9
Investigative Results for this Period	
Referred to Prosecutor	1
Referred for Audit	0
Referred for Administrative Action	1
Oral and/or Written Reprimand	8
Terminations of Employment	1
Demotion	0
Suspensions	0
Debarments	0
Indictments	0
Convictions	0
Monetary Recoveries	\$1,459
Civil Actions (Fines and Restitution)	\$0
Criminal Fines: Fines & Restitution	\$0

Goal 2: Enhance Coordination and Information Sharing with the Congress, IG Community and Others

To achieve our mission, we will need to work closely with Board management, the General Auditors at the Reserve Banks, the Congress, the Inspector General community, and other stakeholders. We plan to continue and expand our coordination with Inspectors General at the financial regulatory agencies to promote consistency in evaluations and priorities and with the IG community across the federal government to provide more global assessments of issues. We will strive to take full advantage of technology and innovative reporting and communications vehicles to enhance information sharing with our diverse stakeholders.

Develop and Enhance Relations with the Congress

By law, the OIG has a duty and responsibility to keep Congress fully and currently informed by means of semiannual and other reports concerning fraud and other serious problems, abuses, and deficiencies relating to the administration of programs and operations administered or financed by the Board, recommend corrective actions concerning such problems, abuses, and deficiencies, and report on the progress made in implementing corrective actions. With the U. S. General Accounting Office increasing its attention on the many broad and more global issues facing the government, we believe we will have a greater responsibility to identify and address current and emerging issues related to Board programs and operations that are of high importance to Congress. Our work under this objective for this reporting period follows:

Review of Legislation and Regulations

As part of fulfilling our mission under the IG Act, we review existing and proposed legislative and regulatory items both as part of our routine activities and on an *ad hoc* basis. We routinely keep track of proposed and pending legislation and regulations by researching relevant documents and databases, reviewing lists prepared by the Board's law library, sharing information with others in the IG community, and coordinating with Board programs that also review new and proposed legislation. We then independently analyze the effect that the new or proposed legislation or regulation may have on the efficiency and effectiveness of Board programs and operations.

During this period, we reviewed a number of legislative proposals for their potential impact on either the Board or on the OIG, and provided advice as appropriate. A large part of our work in this area focused on the various legislative proposals that have been introduced to make permanent the requirements of the Government Information and Security Reform Act, including

the E-Government Act of 2002 (S. 803), and Title XI of the Homeland Security Act of 2002 (H.R. 5005). We also reviewed those provisions of the Homeland Security Act that affect the IG community, with particular emphasis on the amendment which would grant law enforcement authorities to those offices headed by a Presidentially-appointed IG. Additionally, we reviewed, at OMB's request, a draft letter from the Department of Justice that addressed certain aspects of the proposed grant of law enforcement authorities. Finally, we analyzed the provision of the Homeland Security Act that would establish an IG in the new Homeland Security department, and provided comments to the staff of the House Government Reform Committee marking-up the bill.

Our review of legislation and regulations includes reviewing and commenting on revisions or additions to the Board's management policy statements and internal administrative procedures. For example, we analyzed and provided comments on proposed updates to a series of the Board's Management Policy Statements. We also reviewed and provided detailed comments on the Board's draft Incident Response Procedures, which govern the handling of computer security incidents and suspected violations. Our comments were generally well received by Board management and incorporated into the policies and procedures as appropriate.

Improve Our Responsiveness to All Allegations of Fraud, Waste, Abuse, or Mismanagement and to the Public Requests for Information

We are continuing to look for opportunities to improve our timeliness to Board management and staff, Congressional staff, and others concerning allegations of wrongdoing and to enhance our communications with the general public regarding their potential concerns with the Board's programs and operations and their need for information. Our work under this objective during this reporting period follows:

Hotline Operations

Our investigators continued to address allegations of wrongdoing related to the Board's programs and operations, as well as violations of the Board's standards of conduct. During this reporting period, we received ninety-seven complaints, of which ninety-three were from our hotline operation. Most hotline callers were consumers with complaints or questions about practices of private financial institutions. Those inquiries involved matters such as funds availability, account fees and charges, and accuracy and availability of account records. We continued to receive numerous questions concerning how to process Treasury securities and savings bonds. Other callers contacted us seeking advice about programs and operations of the Board, Federal Reserve Banks, other OIGs, and other financial regulatory agencies. OIG investigators directed those inquiries to the appropriate

Board offices, Banks, or federal or state agencies. We closed all but two of the ninety-three hotline complaints after our initial analysis and contact with the complainants.

In addition to the hotline complaints, the investigative services program received four allegations that were referred to the OIG from Board program staff and other sources. As a result of those allegations, the OIG opened four investigations. In addition, we are continuing our review of fictitious instrument fraud complaints. Fictitious instrument fraud schemes are those in which promoters promise very high profits based on fictitious instruments they claim are issued, endorsed, or authorized by the System or a well-known financial institution. Our summary statistics of the hotline results are provided in the table that follows:

Summary Statistics on Hotline Results for the Period of April 1 through September 30, 2002

Investigative Actions	Number
Complaints Referred for Investigation	
Hotline Referrals	93
Audit Referrals	0
Referrals from Other Board Offices	3
Referrals from Other Sources	1
Proactive Efforts by OIG	
Investigations Developed by OIG	0
Results of all Complaints Referred and Proactive Efforts	
Resolved	95
Pending	2
Total Received during Reporting Period	97

Take a Positive Leadership Role in the IG Community

While our primary mission is to enhance Board programs and operations, we are also members of the broader IG community. Executive Order 12805 established the President's Council on Integrity and Efficiency (PCIE) and the Executive Council on Integrity and Efficiency (ECIE). The PCIE is primarily composed of Presidentially appointed IGs, while the ECIE is composed of statutory IGs of designated federal entities. The order directs the councils to continually identify, review, and discuss areas of weakness and vulnerability to fraud, waste, and abuse, in federal programs and operations, and to develop plans for coordinated, governmentwide activities that address these problems and promote economy and efficiency. In addition, the community strives to address a number of common environmental factors, such as auditor and investigator training, OIG operations,

management issues, and legislative changes. Our work under this objective during this period follows:

Executive Council on Integrity and Efficiency Participation

As Vice Chair of the Executive Council on Integrity and Efficiency (ECIE), the Board's IG provides leadership, vision, direction, and initiatives for the ECIE on behalf of the Council Chair (Deputy Director for Management, Office of Management and Budget). Collectively, the members of the ECIE have continued to work with the members of the President's Council on Integrity and Efficiency (PCIE) to help improve government programs and operations. The Inspector General also serves on the Comptroller General's Advisory Council on *Government Auditing Standards* (Yellow Book), a twenty-member group that works with the General Accounting Office to keep the auditing standards current through the issuance of revisions and guidance. Through our membership on the Advisory Council and other groups, we participate in, and set the direction for, a wide range of initiatives including amending *Government Auditing Standards* to ensure a high degree of integrity, objectivity, and independence in audits of government entities.

Foster Interagency Approaches to Cross-Cutting Issues

As noted earlier, major economic, financial, and social trends (such as market globalization, technological and financial innovations, and statutory and regulatory framework revisions) will shape the environment in which the Board and the other financial regulatory agencies operate. These factors will also affect the strategic direction of the regulatory OIGs and require creative and innovative approaches to providing their respective agencies with assistance in managing change, maximizing the use of scarce resources, and ensuring continued compliance with applicable laws and regulations. Our work under this objective during this reporting period follows:

IG Community Participation

Through our membership and leadership role in the ECIE and our continued participation in the Council of Counsels to the Inspector General, we helped set the direction of interagency projects—including audits, inspections, and investigations. We also maintained communications with other groups in the IG community, such as the Government Performance and Results Act Coordinators' Interest Group, that helped us to share review techniques and offer OIG staff the opportunity to network with peers throughout the IG community.

Goal 3: Enhance the Efficiency and Effectiveness of Internal Operations

We plan to continually review our own processes, systems, and resources in an effort to improve our service delivery and to serve as an efficient and effective organization within the Board. Specifically, we plan to improve and streamline our major business processes, continue our investment in human capital, and focus on management approaches to produce the results envisioned in our strategic plan.

Continue to Improve Our Business Processes

Through the effective use of information technology and numerous process enhancements, we have made significant improvements in the way we perform our audits, investigations, and other projects. However, future technological innovations will provide additional opportunities for improvement. Our work under this objective for this reporting period follows:

OIG Security Plan and Control Testing

As part of our program management responsibilities under the Security Act, we completed an information security plan for our primary Lotus Notes applications (which we have designated as “major applications” for our office), and our Notes platform (which we have designated as a “general support system”). The plan was developed to document the basic physical and logical access controls, personnel security controls, contingency planning, and other technical controls related to information security. We also completed a security control test to ensure that the controls identified in the plan are in place and functioning as intended. Using a test plan based on the recently-issued National Institute of Standards and Technology guidelines, we identified several areas for enhancement. During the remainder of 2002, we will develop and implement corrective action plans to address the issues identified during the control review.

Business Recovery and Continuity of Operations

Over the past year, the OIG completed several efforts designed to enhance the office’s ability to quickly recover from a spectrum of possible crisis scenarios. Specifically, we have enhanced daily tape backup operations, established a clustered server to provide our office with a “hot” recovery capability in the event of a failure of either the primary Notes application server or the mail server, established and tested our requirements at the Board’s Recovery Site, and established a portable server capability to allow for recovery of operations using a stand-alone network at any location or to supplement the server capabilities at the

recovery site. We have also established procedures to adjust our backup recovery and continuity of operations as changes occur in the nation's threat level.

Enhance Our Human Capital Through Effective Leadership and Management of Our Staff

Human capital is the fundamental building block to achieving an organization's mission and goal's, and we have integrated human capital considerations in developing our vision and values, goals and objectives, and the strategies to achieve them. Enhancing our human capital will be one of our highest priorities over the next several years. The major objectives are to

- provide opportunities for staff to do different and challenging work;
- expand the staff's opportunities to learn and apply their knowledge and abilities;
- expand staff's career choices, career paths, job enrichment options, and career opportunities;
- allow staff to take responsibility for managing their developmental goals and career options;
- produce experts of the Board's business and in the OIG's mission that will create best solutions for addressing issues and problems impacting the Board's programs and operations;
- allow the OIG to assemble, integrate, and retain highly talented employees who stay at the forefront of their professions;
- make it easier for OIG managers to coach, provide feedback, and develop the staff required to accomplish current and future business strategies; and
- improve the quality of performance and career development discussions between managers and employees.

Our work under this objective for the reporting period follows:

Individual Development Plan Program

During this period, we completed work on our Individual Development Plan (IDP) program that is designed to better direct the investment in our staff's knowledge, skills, and abilities. We developed specific core competencies

targeted at each member's performance level from team member through program manager. We trained the entire staff on the IDP process and completed an initial development plan for each staff member. We will continue to use our IDP program to ensure that the training and developmental activities for our staff are thoughtfully planned and aligned with the mission and needs of our office.

Appendixes

Appendix 1

Audit Reports Issued with Questioned Costs for the Period April 1 through September 30, 2002

Reports	Number	Dollar Value	
		Questioned Costs	Unsupported
For which no management decision had been made by the commencement of the reporting period	0	\$0	\$0
That were issued during the reporting period	1	\$0	\$1,341,195.90
For which a management decision was made during the reporting period	1	\$0	\$1,341,195.90
(i) dollar value of disallowed costs	0	\$0	\$0
(ii) dollar value of costs not disallowed	1	\$0	\$1,341,195.90
For which no management decision had been made by the end of the reporting period	0	\$0	\$0
For which no management decision was made within six months of issuance	0	\$0	\$0

Appendix 2

Audit Reports Issued with Recommendations That Funds be Put to Better Use for the Period April 1 through September 30, 2002

Reports	Number	Dollar Value
For which no management decision had been made by the commencement of the reporting period	0	\$0
That were issued during the reporting period	0	\$0
For which a management decision was made during the reporting period	0	\$0
(i) dollar value of recommendations that were agreed to by management	0	\$0
(ii) dollar value of recommendations that were agreed to by management	0	0
For which no management decision had been made by the end of the reporting period	0	\$0
For which no management decision was made within six months of issuance	0	\$0

Appendix 3

OIG Audit Reports With Outstanding Recommendations

Report No.	Audits Currently Being Tracked	Issue Date	Recommendations			Status of Recommendations ¹		
			No.	Mgmt. Agrees	Mgmt. Disagrees	Follow-up Completion Date	Closed	Open
Objective 1: Improve and Enhance the Board's Program Operations								
A9710	Audit of the Federal Reserve System's Application Commitment Processing	01/98	5	5	0	06/99	4	1
A0004	Audit of the Board's Efforts to Implement Performance Management Principles Consistent with the Results Act	07/01	4	4	0	—	—	—
A0013	Audit of the Board's Oversight Approach for the Federal Reserve's Check Modernization Project	09/01	2	2	0	06/02	2	0
Objective 2: Strengthen and Streamline the Board's Operational Infrastructure								
A9702	Business Process Review of the Board's Travel Administration	07/97	9	9	0	01/99	1	8
Objective 3: Promote the Board's Effective Use of Technology								
A0106	Audit of the Board's Information Security Program	09/01	7	7	0	09/02	1	6
Objective 4: Help the Board Limit Risk and Ensure Compliance								
A0011	Audit of the Federal Reserve Board's Government Travel Card Program	01/02	5	5	0	—	—	—
A0107	Audit of the Federal Reserve's Background Investigation Process	10/01	3	3	0	—	—	—
A0109	Audit of the Board's Use of and Controls Over Purchase Cards	05/02	3	3	0	—	—	—
A0203	Audit of the Board's Security-Related Directed Procurements	09/02	3	2	1	—	—	—

¹ A recommendation is closed if (1) the corrective action has been taken; (2) the recommendation is no longer applicable, or (3) the appropriate oversight committee or administrator has determined, after reviewing the position of the OIG and division management, that no further action by the Board is warranted. A recommendation is open if (1) division management agrees with the recommendation and is in the process of taking corrective action or (2) division management disagrees with the recommendation and we have referred it to the appropriate oversight committee or administrator for a final decision.

Appendix 4

Cross-References to the Inspector General Act

Indexed below are the reporting requirements prescribed by the Inspector General Act of 1978, as amended, for the reporting period:

Section	Source	Page(s)
4(a)(2)	Reviews of legislation and regulations	15
5(a)(1)	Significant problems, abuses, and deficiencies	None
5(a)(2)	Recommendations with respect to significant problems	None
5(a)(3)	Significant recommendations described in previous Semiannual Reports on which corrective action has not been completed	None
5(a)(4)	Matters referred to prosecutory authorities	13
5(a)(5)	Summary of instances where information was refused	None
5(a)(6)	List of audit reports	3-13
5(a)(7)	Summary of significant reports	None
5(a)(8)	Statistical Table—Questioned Costs	25
5(a)(9)	Statistical Table—Recommendations that Funds Be Put to Better Use	26
5(a)(10)	Summary of audit reports issued before the commencement of the reporting period for which no management decision has been made	27
5(a)(11)	Significant revised management decisions made during the reporting period	None
5(a)(12)	Significant management decisions with which the Inspector General is in disagreement	None



*Inspector General Hotline
1-202-452-6400
1-800-827-3340*

*Report: Fraud, Waste or Mismanagement
Information is confidential
Caller can remain anonymous*

*You may also write the:
Office of Inspector General
HOTLINE
Mail Stop 300
Board of Governors of the Federal Reserve System
Washington, DC 20551*